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October 11, 2004

VIA ELECTRONIC MAIL AND 1st CLASS MAIL SERVICE
South Carolina Public Service Commission
ATTN: Docketing Department
PO Drawer 11649
Columbia SC 29211

RE: Application of Total Environmental Solutions, Inc. for Adjustment of
Rates and Charges for Provision of Water and Sewer Collection
Docket No. 2004-90-W/S, Our File No. 557-10022

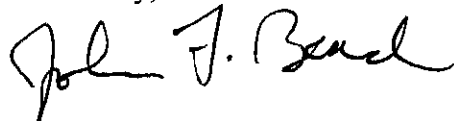
To Whom It May Concern:

Enclosed for filing please find original and ten copies of the **Petition for Reconsideration** for filing by Total Environmental Solutions, Inc. ("TESI") in the above-referenced docket. By copy of this letter, I am serving all parties of record in this proceeding and enclose my certificate of service to that effect.

Please stamp "received" the additional copy of this letter, and return with the bearer of these documents.

With kind regards, I am

Yours truly,



John F. Beach

cc: Mr. Paul Maeder
Mr. Bill Schoening
Mr. Gary Shambaugh
All parties of record

Attachments

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STATE OF SOUTH CAROLINA
BEFORE THE PUBLIC SERVICE COMMISSION
DOCKET NO. 2004-90-W/S

IN THE MATTER OF:)	
)	
Total Environmental Solutions, Inc.)	PETITION FOR
Application for Increase in Rates and)	RECONSIDERATION
Charges for Water and Sewer Services)	
_____)	

Total Environmental Solutions, Inc. ("TESI"), pursuant to S.C. Code Ann., §§58-5-330 and 1-23-10, et seq. (as amended) and the applicable rules and regulations of the South Carolina Public Service Commission (the "Commission"), requests that the Commission reconsider certain other matters addressed in Order No. 2004-434 (the "Order"), issued on September 17, 2004 in the above-referenced docket. TESI received that order on September 20, 2004. In support of its petition, TESI states as follows:

I. INTRODUCTION

On September 27, 2004, the Commission issued its Order No. 2004-434 in this docket. That *order* set new rates for TESI to charge its water and sewer customers. TESI does not contest the Commission's decision to grant certain rate relief for Foxwood Hills, including its conclusion regarding the fair and reasonable operating margin necessary for TESI's water and sewer operations in South Carolina. However, the Commission's decision to exclude certain expenses was not supported by the record. Moreover, its decision to implement TESI's revenue requirement in three phases is not supported by the applicable law.

II. THE COMMISSION ERRED IN ELIMINATING \$19,043 IN DIRECT WAGES AND BENEFITS FOR TESI'S NEEDED FIELD TECHNICIAN

The Commission accepted Staff's recommendation to eliminate \$19,043 in direct wages and benefits during the test year for a third field technician. *Order*, p. 14. The Staff and Commission's justification for rejecting this expense item is that, because TESI had not replaced the technician at the time of hearing, the expense was not "known and measurable." *Id.*

The Commission should make any adjustments for known and measurable changes in expenses, revenues and investments occurring after the test year, in order that the resulting rates will reflect the actual rate base, net operating income, and cost of capital. *Southern Bell v. South Carolina Public Service Commission*, 227 S.C 590, 244 S.E.2d 278 (S.C.1978). Precision is not required for the Commission to meet this requirement, as long as such changes are known and measurable within a degree of reasonable certainty. *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493, .E.2d 92 (S.C. 1992).

TESI's adjustment for direct wages and benefits passed the test as known and measurable because, as Commission Staff itself testified, TESI actually *paid* the salary of a field technician in that position during part of the test year. *Tr.*, vol. 3, p. 62, ll. 4-7. Moreover, the *only* evidence in the record is that this field technician is essential to the proper operation of the Foxwood system, and needs to be filled. *Tr.*, Vol. 2, pp. 2232-224. Indeed, the Commission Staff testified that while it eliminated this expense, it was not asserting that the additional employee was unnecessary. *Id.* The Staff actually went on to testify that if the Commission accepted the necessity for a third field technician, it could utilize TESI's existing salary information to accurately adjust the test year expenses for this added personnel. *Id.*

For these reasons, the Commission should adjust the rates it ultimately adopts in this

proceeding to include an additional \$19,043 in direct wages and benefits. Any other decision would have absolutely no support in the record of this proceeding.

III. THE COMMISSION ERRED IN ELIMINATING APPROXIMATELY \$21,800 IN AFFILIATED SERVICES COSTS

The Commission eliminated approximately \$21,800 in TESI's affiliated service expenses. In so doing, the Commission accepted Staff's proposed adjustments in primarily three areas: 1) General Administrative and Office Expense; 2) Depreciation – Office Building in Baton Rouge Louisiana; and 3) TESI's calculated 20% coverage factor.

General Administrative and Office Expenses.

During its audit of TESI's books, Staff reviewed invoices for every dollar of expense proposed by TESI. Staff chose to arbitrarily reduce these known and measurable expenses, and offered absolutely no basis for its adjustments in their testimony or exhibits.

Depreciation – Office Building in Baton Rouge Louisiana

The Order erroneously accepts the Staff's elimination of *all cost* for TESI's Baton Rouge corporate headquarters office space. TESI's corporate offices house management, engineering customer billing, customer service, accounting, finance and record storage. Every one of these functions is critical to operating Foxwood Hills. Eliminating the costs of TESI's corporate office space is unreasonable and arbitrary.

Coverage Factors

TESI's rate filing includes 5% and 20% coverage factors added to certain portions of its affiliated services costs. It was error for the Staff and Commission to disallow these coverage factors under the theory that they are contingencies, and therefore not known and measurable.

It is a fact that TESI's lenders require coverage factors on debt, and require the company to meet certain covenants on its debt. These coverage factors and contingencies or covenants are real, known and measurable. It is error for the Commission to accept Staff's arbitrary proposal to eliminate these unavoidable parts of TESI's cost of doing business.

IV. THE COMMISSION ERRED IN FAILING TO CORRECT TESI'S ASSET BASE, WHICH RESULTED IN THE ARBITRARY ELIMINATION OF APPROXIMATELY \$101,701 IN DEPRECIATION EXPENSE, AND \$14,258 IN INTEREST EXPENSE.

In support of its rate application, TESI presented an original cost study establishing gross utility plant in service totals of approximately \$2,356,697 and \$3,108,879 for the Foxwood water and sewer systems, respectively. When these capital amounts are depreciated based upon the original cost values when first dedicated to public service, the current net book values for water and sewer are as follows:

	<u>Net Book Value</u>
Water Utilities	\$1,682,237
Sewer Utilities	<u>2,067,522</u>
	\$3,749,759

While TESI believes that the Commission erred in failing to adopt TESI's position, it will focus upon the Staff's alternative proposal in this Petition for Reconsideration.

At hearing the Staff asserted an alternative proposal which would correct TESI's books to reestablish TESI's rate base at \$1,609,342. TESI accepts Staff's alternative proposal in theory, and would agree to it if the Commission remedies two serious flaws.

The Staff Proposal Incorrectly Assumes that Every Lot Owner has paid a \$650 Connection Fee.

Staff's alternate proposal subtracts \$2,585,700 as contributions in aid of construction from TESI's calculated Total Plant in Service less Accumulated Depreciation. *Tr.*, vol. 2, p. 31. Staff's subtraction incorrectly assumes that every one of the 3,978 lots sold at Foxwood paid the utility (then-owned by the developer) a full \$650 connection fee. The record is completely void of any evidence to support Staff's assumption. Though the record does suggest some initial intent to charge a full \$650 on each sale, the developer was completely free to waive all or part of this connection fee in order to close a particular deal.

The ultimate value of escrow account that DHEC established to enlarge the Foxwood wastewater treatment plant ("WWTP") suggests that the Staff's numbers are grossly overstated. The developer funded this account with only \$300,000 in connection fees. Exhibit 7 to *Application*, included in collective Hearing Exhibit 2. Since the Escrow Agreement required Developer and its utility company to deposit \$300 per purchasing lot owner, at most, the escrow account balance suggests that the developer only collected connection fees from 1,000 lot owners. The Commission could fairly conclude that this escrow account balance supports approximately \$650,000 in actual connection fees (1,000 x \$650), but no more. Based upon this, the Commission should add back \$1,935,700 (\$2,585,700 - \$650,000) to Staff's proposed rate base correction. With this correction, Staff's alternative proposal would yield a rate base of \$3,545,042.

The Staff also subtracted \$351,756 in enhancement fees from its alternative calculation. TESI addresses this error in the following section.

Perhaps more important than the numbers themselves, the Commission's decision not to correct TESI's rate base is detrimental to Foxwood Hills customers from a policy perspective. The Commission Staff's alternative proposal presents a clear demonstration of this detriment.

The Commission has currently approved rates for Phases 2 and 3 as follows:

	<u>After 2nd Phase of Increase</u>	
Operating Revenues	\$ 504,355	
Operating Expenses	<u>444,537</u>	—
Net Operating Income/Loss	\$ 59,818	
Add: Customer Growth	<u>0</u>	
NET INCOME/(LOSS) FOR RETURN	<u>\$ 59,818</u>	
Operating Margin	<u>11.86%</u>	

	<u>After 3rd Phase of Increase</u>	
Operating Revenues	\$ 609,624	
Operating Expenses	<u>487,718</u>	—
Net Operating Income/Loss	\$ 121,906	
Add: Customer Growth	<u>0</u>	
NET INCOME/(LOSS) FOR RETURN	<u>\$ 121,906</u>	
Operating Margin	<u>20.00%</u>	

In setting these rates, the Commission perceived that TESI must ultimately have an opportunity to earn \$609,624 in operating revenue in order to maintain financial stability. In order to accomplish this, the Commission correctly ruled that TESI was entitled to a 20% operating margin. The Commission's acceptance of Staff's \$487,718 in operating expenses causes TESI to show net income of \$121,906 after implementation of Phase 3¹.

In comparing the Phase 2 and Phase 3, it is instructive that TESI's net income must increase by approximately \$60,000 in order for TESI's operating margin to increase from approximately 12% to the fair and reasonable 20%. This is almost exactly the amount of additional depreciation and interest expense resulting from Staff's alternative proposal to correct TESI's rate base back to \$1,609,342.

¹ TESI is providing this illustration, without waiving TESI's position that its actual expenses are substantially greater than the Commission calculation of \$487,718.

As a general proposition, TESI's customers would be much better off if TESI earned the same \$609,624 in annual rates, but did so through Staff's additional \$60,000 depreciation and interest expenses, and a \$60,000 lower net income, than the same annual rates through lower expenses and a higher net income. This is true for three reasons.

First, earning the rates from lower expenses and higher income causes a larger part of TESI's Phase 3 revenues to go to state and federal governments in the form of income taxes. Under the Staff's alternative proposal, an additional \$30,000 in depreciation expense would be devoted to the replacement of Foxwood Hills' water and sewer infrastructure at the end of its useful life.

Second, a Commission decision to correct TESI's rate base creates value in the Foxwood system. TESI is under orders from DHEC to double the size of Foxwood's WWTP and substantially upgrade certain aspects of its water system during the next 24 months. In order to accomplish this, TESI must borrow money from commercial lenders. To qualify for loans on the most favorable financial terms, TESI must demonstrate two things to its lenders: 1) that the Foxwood system is producing sufficient rate revenue to cover all of TESI's operational costs; and 2) that the system has a substantial and realistic asset value. *Tr.*, vol. 2, pp. 99, 107. If the Commission does not allow TESI to make this asset base correction, TESI will inevitably be forced to borrow money for these and other future capital projects at higher interest rates and costs. *Id.*, vol. 2, pp. 217-218, 247. TESI's customers will be the ones to ultimately pay for these increased costs through future rate increases. *Id.*

V. THE COMMISSION ERRED IN APPLYING APPROXIMATELY \$351,756 IN ENHANCEMENT FEE “INCOME” AS CONTRIBUTIONS IN AID OF CONSTRUCTION.

In both the Staff’s proposed negative rate base of (\$61,980), and its alternative proposed rate base of \$1,609,342, staff unlawfully included \$351,756 in enhancement fees as contributions in aid of construction. Even the Staff’s negative rate base assertion would become positive if enhancement fees were treated correctly.

Staff’s first error was to count TESI’s *billed* enhancement fee amounts for 2002 and 2003, instead of its *collections* (in accrual accounting collections are equal to billed amounts minus bad debt). *Tr.*, vol. 3, pp. 40-41. Staff established that TESI’s actual collections for 2002 were the billed amount of \$175,728 minus its bad debt amount of \$(147,735), or \$27,993. 2003’s actual collections were similarly lower at \$167,037 minus \$(124,392), or \$42,647. Thus, the Commission’s *Order* overstates enhancement fees by *at least* \$281,116.

Applying billed instead of collected enhancement fee amounts as contributions in aid of construction directly violates the NARUC Uniform System of Accounts. Section 271, Contributions in Aid of Construction, specifies that this account shall only include:

- “A. 1. Any amount or item of money, services or property *received by a utility . . .*
4. Any amount of money *received by a utility . . .*”

This is in sharp contrast to Sections 400, 460, and 461, which define “Operating Revenue” to include “the net *billing*” for water supplied to the customer.

The Commission’s decision to count all net billings of enhancement fees not only violates the NARUC Uniform System of Accounts, but also incorrectly treats these fees as operating revenue. This decision violates the Supreme Court ruling in *Total Environmental*

Solutions, Inc. v. South Carolina Public Service Commission, 351 S.C. 175, 568 S.E.2d 365 (2002), which holds that the Commission may not consider amounts earned from enhancement fees when the record, as here, is void of any evidence that the utility received or directly benefited from the fees².

The Commission bases its decision to ignore actual collections upon the Staff's notion that TESI has not "exhausted all possible attempts to collect these funds." *Order*, p. 20. Accordingly, the Commission states that it will continue to apply all future *billed* enhancement fee amounts to TESI's rate base until TESI can prove to the Commission that it "has exhausted all possible avenues to collect these amounts." *Id.*

Not only is this aspect of the Commission's decision legally unsupportable, but it is wrong from a policy perspective, as it places a very unfair burden upon TESI and its customers, going forward. The Commission's decision requires TESI to now expend utility resources every year in attempting to collect enhancement fees. Since enhancement fees are not approved utility rates, and are not charged to utility customers, South Carolina's utility laws provide TESI with no efficient means of compelling lot owners to pay. The *Order*, thus, forces TESI to take the economically imprudent steps of pursuing up to 3,000 individual legal cases against lot owners, none of which will be for more than the lot owner's \$60 annual obligation. Since these collection attempts are expressly mandated by the Commission's *Order*, the Commission *must* charge Foxwood customers with the costs of TESI's collection attempts in future rate proceedings. See Staff's acknowledgement of this concept, *Tr.*, vol. 3, pp. 69-70.

Thus, even if the Commission completely rejects TESI's proposal to add its plant in service of \$3.7 million back onto its books, and rejects the Staff's alternative proposal to add

² The Commission's decision also violates the Supreme Court's ruling in *Total Environmental Solutions, Inc. v. South Carolina Public Service Commission* because the Commission here also counts 2003 enhancement fees, when those fees were clearly collected by Total Environmental Solutions Management of Louisiana, Inc., and not TESI.

\$1.6 million back, it still must correct its error regarding enhancement fees, which will in any event result in a positive rate base. This, in turn, will result in additional depreciation and interest expense for TESI's Foxwood operation, and the addition of depreciation expenses associated with TESI's corporate offices in Baton Rouge.

VI. THE COMMISSION ERRED IN ADOPTING A PHASED- IN RATE STRUCTURE THAT REQUIRES TESI TO OPERATE UNDER A NEGATIVE OPERATING MARGIN DURING THE FIRST YEAR, AND FAILS TO IMPLEMENT THE REQUIRED 20% OPERATING MARGIN UNTIL THE THIRD YEAR.

On page 34 of its Order, the Commission concludes as a matter of law that "A fair operating margin for the water and sewer operations of TESI in South Carolina is 20.00%." On its own, this finding satisfies the Commission's obligation "to approve rates that are just and reasonable, not only producing revenues and an operating margin within a reasonable range, but which also distribute fairly the revenue requirements, considering the price at which the company's service is rendered and the quality of that service." *Seabrook Island Property Owners Ass'n. v. South Carolina Public Service Commission*, 303 S.C. 493, 499, 401 S.E.2d 672, 675 (S.C. 1991). However, when paired with the phased-in rates adopted by the Commission in this case, the Commission's decision breaches this obligation.

TESI is allowed by statute to file another rate change request twelve months after placing the subject rates into effect. *S.C. Code Ann.*, §58-5-240 (F). The Commission must rule upon that application six months after it is filed. *Id.*, §58-5-240 (C). The Commission's approved rate schedule requires TESI to operate at a negative (6.91)% operating margin during that first twelve months, and then only at 11.86% for Phase 2. Thus, if TESI avails itself of the statutorily

established 18 month rate cycle, the Commission's phased-in rate schedule forces TESI to experience a negative (.653)% operating margin. This negative operating margin constitutes a *per se* violation of the Commission's obligation to approve rates that are just and reasonable. If such phased-in rates were legally permissible, the Commission could prohibit TESI from *ever* earning a positive operating margin by simply approving a succession of similar phased-in rate schedules in response to future rate applications.


The Commission cites *Hamm v. South Carolina Public Service Commission*, 294 S.C.320, 364 S.E.2d 455 (1988) ("*Hamm*") in support of its phased-in rate ruling. TESI's case is distinguishable from that one for three crucial reasons. First, the Commission did not adopt a phased-in rate schedule in *Hamm*. There, the Commission found that, after placing the V.C. Summer plant into service, the SCE&G system had 400 MW of excess capacity. Based upon this finding, the Commission only phased a portion of the cost of that plant into SCE&G's rate base, phasing the remaining cost into SCE&G's rate base "as the necessity arises." *Id.*, at p. 326, 364 S.E.2d at p. 458. That is an entirely different matter than here, where the Commission has chosen to phase in a portion of an operating margin the Commission has already found to be necessary for TESI to have financially stable operations. The present case is also crucially different from *Hamm* because in that case the Commission never required SCE&G to operate at a loss, but instead provided SCE&G with the immediately opportunity to charge rates that would provide it with a fair and reasonable return. Finally, *Hamm* does not establish the legality of a phased-in operating margin. In addition to being factually different from the subject rate model, no party in *Hamm* actually contested the Commission's decision to phase only a portion of the cost of the V.C. Summer plant into SCE&G's rate base. Consequently, the Commission's

decision to phase in the cost of that plant during the underlying rate case was not even a contested issue on appeal.

For these reasons, the Commission should reconsider its decision, and allow TESI to immediately charge appropriate rates that would otherwise be delayed until Phase 3.

WHEREFORE, having fully set forth its grounds for this petition, TESI respectfully requests that the Commission reconsider Order No. 2004-434, as set forth herein, and grant such other relief as the Commission deems just and proper.

Respectfully submitted,


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October 11, 2004

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**STATE OF SOUTH CAROLINA
BEFORE THE PUBLIC SERVICE COMMISSION
DOCKET NO. 2004-90-W/S**

IN THE MATTER OF:)

Total Environmental Solutions, Inc.)
Application for Increase in Rates and)
Charges for Water and Sewer Services)
_____)

CERTIFICATE OF SERVICE

This is to certify that I have caused to be served this day, one (1) copy of the **Petition for Reconsideration** via electronic mail and by placing a copy of same in the care and custody of the United States Postal Service (unless otherwise specified), with proper first-class postage affixed hereto and addressed as follows:

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